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SUBJECT: Daimler and Porsche: Differing Challenges in Reducing CO2 Emissions

REF: A. Munich 0175
¶B. Berlin 0560
¶C. Munich 0100

¶1. SUMMARY: The proposed European Union directive requiring car manufacturers to lower CO2 emissions significantly by 2012 presents major challenges to Daimler and Porsche, both German manufacturers of high-end, high-powered automobiles. Neither firm has expressed confidence that it will reach the required goal in time, but Porsche appears to be impossibly far away from reaching it and resigned to its fate. Both firms will look to the German government to lobby the EU for more lenient restrictions, while Porsche likely will also try to acquire a majority stake in Volkswagen, thereby pooling the fleets and lowering the overall CO2 emissions average. END SUMMARY.

Daimler: Confident of Meeting Target, But Not in Time
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¶2. Senior Daimler executives told ConGen Econ Officer and Econ Specialist that their company had long ago realized the importance of reducing CO2 emissions and increasing energy efficiency to the auto industry's future. They expected their fleet would have an average CO2 emission of 136 g/km in 2012, and would not meet the EU requirement of 130 g/km until 2015. Therefore, the company is currently lobbying the German government and the EU for a three-year extension of the phase-in period to 2015, arguing that nearly 90% of all models to be sold in 2012 can no longer be modified since they are already in the advanced engineering or production phase. Daimler has succeeded in lowering its emissions average in recent years by developing new technology, but is also helped by its light-weight, more fuel-efficient Mercedes A-class Smart cars.

¶3. The executives expressed doubt that certain high-powered automobiles, such as the Mercedes S-class, would ever comply with the proposed 60% maximum overrun of the average and are therefore lobbying for an overrun of 80%. They also criticized the current EU draft, which Daimler believes ignores innovations that have reduced CO2 emissions, such as energy-efficient lights, solar-paneled glass roofs and gear shift indicators. Daimler expressed dissatisfaction with the level of the fines for non-compliance. These will begin in 2012 and reach 95 euros per gram by 2015. According to Daimler's calculations, the fines are around twenty times greater than those that apply to energy providers in the CO2 emission trading system.

¶4. Daimler executives maintained that the German government understood Daimler's concerns and is an honest broker in making its case to the EU. They expected less understanding for their plight in the EU Council, where positions were already fixed, and in the EU parliament, where many members vote along national lines on the issue. Should no compromise be achieved, the company expects the German representation in the EU Parliament to organize a blocking vote along with the United Kingdom, the Scandinavian countries and several East European partners, against a tightening of restrictions

to 120 g/km.

Porsche: $CO_2$ Emissions an Existential Threat
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¶5. A senior executive at Porsche called EU $CO_2$ regulations a direct threat to its very existence. At present, Porsche's fleet has an average emission of 290 g/km, impossibly far away from the target of 130 g/km. Although Porsche is designing a hybrid car and a diesel-powered SUV, technology simply does not exist to make its fleet comply while maintaining the high performance standards that distinguish Porsche. The executive echoed Daimler's criticism of the anticipated non-compliance fines, which Porsche would have to pass on to the consumer and which, in turn, could dramatically affect sales.

¶6. Speaking candidly, the executive described the legislation as a deliberate attack on this segment of the German automotive industry, supported by France and Italy, whose car industries produce smaller, more energy-efficient vehicles. Porsche's biggest competitor, Ferrari, has the advantage of pooling its fleet with Fiat, making its high-emitting cars statistically insignificant. Porsche hopes to pursue a similar arrangement by increasing its ownership share in Volkswagen (VW) from 30.9% to over 50% and pooling the two fleets.

¶7. Pooling Porsche and VW may prove difficult as the government of VW's home state of Lower Saxony owns 20.8% of the company, and local political leaders fear losing control of an economic force in their region. Moreover, Chancellor Merkel has expressed support for redrafting a "VW Law" in Germany, which would limit voting rights in the company to 20%. The EU struck down Germany's "VW Law" only last



year, saying that it violated free movement of capital. The executive said Porsche's relationship with the federal chancellery was not as good as under former Chancellor Gerhard Schroeder, who, coming from Lower Saxony, had a solid understanding of the German automobile sector.

Comment
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¶8. Like most car manufacturers in Germany, Daimler and Porsche will lobby hard to change EU $CO_2$ regulations, which pose severe challenges for the premium car market. Though both companies would be hit hard, Daimler is better positioned for eventual compliance and may even benefit, should Porsche's losses in business translate to Daimler's gain. Porsche faces the greater crisis, since it has little hope of bringing its $CO_2$ emissions down far enough and may face political opposition in its attempt to acquire a majority stake of Volkswagen to pool its fleet. The challenge for the German federal government is to lobby for the domestic car industry in the EU while also balancing the competing interests of the various German manufacturers. END COMMENT.

¶9. This cable was coordinated with Embassy Berlin and ConGen Hamburg.
POWELL